CONGRESSMAN'S REPORT
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Preparing for Peace--V

Tax Reform and the Double Standard

Unto every one that hath shall be given; and he shall have abundance: but from him that hath not shall be taken away even that which he hath.
--Gospel of St. Matthew

A few weeks ago you and I and 75 million other Americans proved again that the Federal income tax system of the United States is the greatest money-collecting operation in the history of the world. By midnight of April 15 nearly all of us had completed the painful task of reviewing our 1968 incomes and reporting the results, along with such remittances as were indicated, to the Internal Revenue Service. Through our combined agonies the Federal government will collect about $85 billion in *personal* income taxes and $38 billion in *corporation* income taxes this year.

The remarkable thing about our tax system is that it is essentially voluntary; we assess ourselves. In fact, I'm told that the IRS receives hundreds of millions of dollars every year from people it never previously knew existed.

Why is this annual raid on American pocketbooks such a huge success? The answer is two-fold. For one thing, there is the fear that someone from IRS might pay a not-so-friendly call if one fails to cooperate. For another -- and this is the main reason it works -- *most Americans believe the system is basically fair*. They believe that people with equal incomes pay about equal taxes. And they think that, as incomes go up, the percentage people pay in taxes goes up; the system, they understand, is *progressive,* based on the ability to pay.

Unfortunately, this confidence in the fairness of our tax system is not self-sustaining; it can be eroded, and it is becoming a bit shaky right now. Increasingly, taxpayers are finding out that equal incomes don't *necessarily* mean equal taxes and that our "progressive" tax structure isn't really very progressive at all. The heavy burdens of the Vietnam War, including costly inflation and a 10% war surtax, have added to this uneasiness and prompted one of the liveliest debates in years on the issue of tax reform. After all, the surtax applies only to the tax you're already paying; if, through tax loopholes, a man pays zero taxes, he pays zero surtax. Understandably, that makes some people mad.

CONCEPT VS. REALITY

Like woman suffrage and repeal of Prohibition, the Federal income tax has had its grumblers and complainers ever since it was added to the Constitution in 1913. And, all practical considerations aside, I'm sure we would all like to go back to those seemingly happy days when there was no income tax. Some people seriously propose its abolition, even today. But those days are gone, and it would be misleading to suggest that our country could hold together without the kind of revenues only made possible by a broadly-based income tax.

Since the income tax fills such a vital need, it is sad to realize what has happened to it through the years; it has become a kind of topsy-turvy welfare system, unwittingly granting all sorts of favors and benefits to the well-to-do, who don't need them, and imposing excessive burdens on those in the great American middle-class, who could use a few breaks for a change. Under our present Internal Revenue Code things like this have come to pass:

> ** In 1967 there were 21 Americans with incomes of more than $1 million who paid *no taxes at all* -- legally.
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> ** Many citizens still worry about the "confiscatory" taxes paid by the rich -- particularly the 70% rate that applies to top-bracket income (over $200,000 for married couples). However, the truth is that eight out of 10 with incomes over *$1 million* pay an effective rate of *less than 30%*, often lower than persons with a small fraction of their incomes.

In the course of the last 56 years the Federal income tax has grown from a few dozen pages of fairly simple rules to a complicated jungle of some 1500 pages, few of which have much to do with you. But for a small number of fortunate people who can afford the lawyers and accountants who know their way through that jungle, these pages offer innumerable devices and gimmicks to reduce or even eliminate one's tax obligations.

Let me emphasize that I see nothing immoral or improper about the use of our tax laws for this purpose. As long as these provisions are in the law, taxpayers have a right to use them. But I think it is highly immoral and improper for the *Congress* to perpetuate these inequities or to create new ones.

REFORM ISN'T EASY

It's important to understand how our Federal tax code got this way. It isn't that Washington is filled with villains and ogres who think only of robbing the poor to pay the rich. Virtually all of the inequities in the income tax have a common origin. Long ago, for some legitimate social or economic purpose, a class of taxpayers was given a preference (an extra exemption, a deduction or a special computation method). An example, subject to little controversy even today, is the extra exemption of $600 accorded blind persons. But over the years some of these preferences have become distorted and stretched, applied to situations Congress never anticipated, and benefiting persons Congress never intended to benefit. In some cases the original purpose has been almost forgotten.

Doing something to correct these inequities is not easy. Closing a loophole, once opened, is like trying to plug a dike at high tide with the ocean pounding through. The people who benefit, who have come to depend on certain of these preferences for their investments or income, will fight tenaciously and effectively against change. And, when you add up the beneficiaries of these preferences, Congress faces a very formidable opposition to any comprehensive effort at tax reform. Already, in response to tax reform hearings conducted by the House Ways and Means Committee, my mail is beginning to reflect strong and organized opposition to any action on oil depletion, capital gains and other preferences.

Fortunately, support for tax reform is developing, too. I have one constituent in Casa Grande, for example, who has made this almost a personal crusade. Other concerned citizens in Arizona and elsewhere are beginning to demand that Congress face up to this challenge. And as one congressman out of 435 I intend to do what I can to bring that about.

A CHAMBER OF SELECTED HORRORS

Keeping in mind that every time someone escapes a tax he otherwise would have to pay, *someone else has to make it up* (if you're salaried, usually *your* name is placed in nomination), let's take a look at a few of the loopholes in our Internal Revenue Code. There are many, many more, of course. This will be merely a chamber of *selected* horrors.

The Capital Gains Windfall

Each of four married taxpayers had an income last year of $50,000. Each had two children to claim as exemptions. Taxpayer A played baseball, B wrote a book, C was a surgeon, and D sold an invention for a pretzel bender. After computing their taxes, Taxpayers A. B and C each paid the IRS $13,338, or 26.8% of his gross income. However, Taxpayer D, taking a "capital gain" on the sale of his invention, paid only $4,412, or 8.8% of his gross income.

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Each of three married, but childless, taxpayers had incomes last year of $8,000. Bill was a school teacher, Joe the owner of a hardware store, and Jack a kind of drifter with a few dollars to invest. Bill and Joe each paid $1,000 in Federal income taxes. Jack, having made all of his income on a "hot" stock he held for 6 1/2 months, reported his $8,000 as a "capital gain," was able to deduct half of this as tax-free, and paid $354 tax on the remainder. His saving compared to Bill and Joe: $646.

Inequities of this kind are not the exception in our tax system; they're the rule. Money derived from *labor,* whether physical or mental, pays the full rate; money derived from *money* -- that is, investments -- pays much less.

Passed in 1921, the capital gains tax made sense originally. It was designed to encourage business investment and to cushion the impact of appreciation in property values which has occurred over a number of years. For example, if a man built a factory and owned it for 20 years, during which time it gained in value by $100,000, it would seem to be unfair to make him pay taxes on the entire $100,000 in the year of sale (say at a 70% rate) when what had actually occurred was that he had made $5,000 a year for 20 years.

For a time the capital gains tax was computed on a sliding scale according to the length of time involved; longer periods of investment were given greater consideration than shorter periods. But over the years the length of time property had to be held to qualify for full "capital gains" has shriveled until now it's only six months. And over the years the kinds of property and business situations covered by the capital gains tax have greatly increased in number and complexity. One crazy contradiction: income from the sale of *Christmas trees* is a capital gain; income from the sale of *apple trees* is ordinary income.

In 1966 there were 644 people who declared incomes of more than $1 million. Of these, 362 made more than half of their income on capital gains. The *average* gain was more than $4 million.

I'm sure most Americans have nothing against the idea of encouraging business investment. I'm for a policy which will provide the money to keep our economy growing at an orderly rate. But surely there are better ways of encouraging investment than *this.* Quite simply, the effect of capital gains taxation is a tremendous tax break for the people who have money to invest as against people who have only time, labor or professional skill to invest.

Annual revenue loss, which must be made up by higher taxes on you and other taxpayers: $6 - 7 billion.

The Municipal Bond Shelter

At the age of 21 the son of a successful real estate promoter finds himself with $1 million to invest. Lacking the gambling instincts of his father, he instructs his broker to purchase tax-free municipal bonds, currently selling for 5 1/4%. Thereafter he spends his time clipping coupons, collecting his interest and relaxing at the country club. His annual income from these investments: $52,500. His Federal income tax: <u>zero</u>.

Bear in mind that the same young man, earning that much money through sheer genius and hard work, would have had to pay a tax of $22,980 if single, or $14,468 if married with two children. Instead, he pays nothing. *Our* taxes defend him from all enemies, foreign and domestic. When he uses a Federal airport, a harbor, a national seashore or park, he goes as *our* guest; you and I pay his way. And, ironically, with all his tax-free money, he's more likely to use such facilities than we are.

Like other tax preferences, this one began with a very legitimate purpose: to help cities, counties, sewage districts, school districts and the like to borrow money for improvements at low interest. I don't suppose it occurred to Congress that this could become a tax shelter for the very rich. Yet it has.

In 1967 persons in the over-$100,000 class collected *$440 million* in tax-exempt interest from municipal bonds. The reason: tax-exempt interest, while lower than other interest, yields a greater return, after taxes, than most other investments.

I'm certainly for helping cities and school districts, and to this end I've voted for Federal programs which would provide them with substantial aid through loans and grants. But I feel this country must find a better and more efficient way of easing their financing problems than this system which provides a tremendous tax break to a very small class. Tax-free bonds save these local borrowing agencies about *half as much* as they cost the Federal government. The difference goes into the pockets of the bondholders.

Annual revenue loss: $1.8 billion. Saving to local borrowing agencies: $.9 billion.

The 'Family Farm' Gambit

A movie star with income in the 70% bracket invests $200,000 in a breeding herd and a year's supply of feed. On his tax return he's a perfectly lousy farmer, for he shows this entire amount as a "loss" for the year, reducing the taxes on his movie income by $140,000.

The next year he sells the herd for $200,000, his original cost. Ah, you say, now he'll pay his rightful taxes; obviously, on the purchase and sale he broke even. Wrong! You see, the entire sale goes as a capital gain, and his tax is only 25%, or $50,000. Thanks to his terrible luck at farming, he is left with a net saving in taxes of $90,000 in two years -- and all of his original money back.

Years ago, in an effort to make bookkeeping easier for the average dirt farmer -- struggling over his ledger under a coal-oil lamp -- Congress passed a law allowing him to use the "cash" rather than "accrual" method of accounting for income and expenses. This option was helpful to ordinary farmers and made little difference in their taxes. But, as we have seen before, it didn't stop there; rich movie stars, brokers and advertising men saw in it a means of greatly reducing *their* taxes. And outrages like the one above began to appear. There are today many astute, upper-income taxpayers who have suddenly become "family farmers" -- but who never feel the soil.

There are *two* great evils here. One is the tax loophole which undermines the progressive income tax and gives an enormous advantage to people with a lot of money to invest. The other is the effect this practice has on ordinary farmers, who are trying to make an honest living growing crops and raising livestock. Entry of the tax-avoiding investor into agriculture tends to drive up the price of land and put the small farmer at a disadvantage in selling his produce.

Annual revenue loss: $145 million.

Oil Depletion Forever

As you file your next income tax return, shed a tear for the nation's leading oil companies, which have obviously fallen on hard times. Just look at what desperate straits they are in:

From 1962 through 1966 the Atlantic-Richfield Oil Co. had profits of $411,621,00. But after deducting its 27 1/2% oil depletion allowance, "intangible drilling costs" and other items it came up with a whole string of goose eggs. Its total income tax obligation for those five years: ZERO.

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In 1962 the Marathon Oil Co. had a net profit of $36 million. After deducting its depletion allowance and other items Marathon not only paid no income tax but received a <u>tax credit</u> of $2.2 million.

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In 1965 the 20 largest oil companies in the United States had aggregate profits of nearly $6 billion. Taking advantage of special preferences in our tax laws, they paid income taxes representing only 6.3% of these profits -- the same rate paid by a married taxpayer with two children earning just $4,900 -- and 41.7% less than the rate paid by most U.S. corporations.

Shocking examples like these reflect no dishonesty on the part of oil companies; they reflect a failure of Congress to face up to the glaring inequities in our income tax system.

Again it's the old story of special tax provisions written for a worthy purpose becoming a shelter for the favored few. There is no doubt that drilling for oil is risky and uncertain business. The majority of holes drilled bring up nothing more than mud. Recognizing the need for oil exploration and development, Congress devised the "oil depletion allowance" to encourage risk-taking in this field. Unfortunately, it went overboard in its generosity.

Depreciation is a concept all businessmen understand. You build a building, and you deduct a portion of its cost each year from your income tax until, about the time its usefulness ends, you have deducted the full amount.

Not so with the oil depletion allowance. In this case you determine your income from a producing well and deduct 27�% of that amount before beginning to calculate your income tax. You do the same next year, and the year after that, and every year as long as that well produces. You don't stop when you have retrieved your investment; in fact, the *average* well is "depleted" 12 times over. If your drilling cost was $50,000, your total income tax deductions on its production might be $600,000.

And that isn't all. In truth, most of that $50,000 will have been deducted while you were exploring and drilling for the well. This is possible because Congress has provided for deduction of "intangible drilling costs" as current expenses; it turns out that most exploration and development costs end up in this category.

What works for oil works to a lesser extent for other minerals. Sulphur and uranium get a depletion allowance of 23%, for example, and copper gets 15%. But oil accounts for 60% of all depletion claimed.

Annual revenue loss from excess depletion ("depleting" oil wells more than once): $1.3 billion. Additional revenue loss from "intangible drilling cost" deductions: $300 million.

Charity that Begins at Home

> **Like everybody else, you don't like to pay taxes. Let's suppose you prefer to give your money to charity, especially a small college founded on the principles of the John Birch Society, a national religious "crusade," and a certain foundation which bears your name. You find your regular income this year will be $5 million. Not wanting to pay any of this in taxes, you dig out some old stock certificates which cost you $150,000 back in the '30s. Now they're worth $8 million. Through a quirk in the law you know you can get a deduction of $8 million by contributing your stock to charity without ever showing this capital gain as income (not even capital gains income). Thus, your**

contributions for the year appear to exceed your total income, and you pay no tax; in fact, you get a $3 million tax credit. The entire $5 million is yours to spend on yachts, airplanes, or possibly a campaign to abolish the income tax!

Americans are a generous people, and our tax laws tend to make them even more generous. However, for most taxpayers the upper limit of deductible contributions is 30%.

Not so for a handful of extremely rich citizens who often join the extremely poor in the non-taxpayer category. Through use of an "unlimited charitable deduction" provision in our tax laws they have managed to greatly reduce or eliminate their otherwise heavy tax obligations.

To qualify, you must have given more than 90% of your taxable income to charity for 8 of the preceding 10 years, meanwhile getting credit for only 30%. The secret word is "taxable." Through tax-free municipal bonds, capital gains and other devices this isn't as difficult as it may seem. Once you qualify, you can deduct any amount you wish to charity -- and get full credit for it.

Aside from the matter of fairness and equity, the obvious question here is: should any taxpayer have the right to decide whether he is going to support his government *or* his favorite charities? As it is, you pay the bill for people like this while they give to *their* favorite charities -- not yours.

Annual revenue loss: $50 million.

THE COMPLEAT NON-TAXPAYER

Just how bad our tax system has gotten is revealed in the following real-life, but anonymous, cases provided by the Internal Revenue Service. Let me emphasize: I didn't make these up; they *actually happened*.

Taxpayer X, a real estate developer, is a real loser; he "loses" when he buys, and he "loses" when he sells. His income in 1966 was $1,433,000. But wait. He wrote off $575,000 as the tax-free portion of his capital gains. And, figuring accelerated depreciation on buildings he owned, he was able to show a "loss" of $864,000, totally wiping out his tax obligation.

The IRS says he can be expected to sell these "losing" investments later on for a capital gain on which, in spite of his high income, the tax will be only 25%.

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Taxpayer Y, an investor of note, had income in 1966 of $1,284,718. This included his $20,000 salary plus dividends, interest and $1,210,426 in capital gains. The capital gains were realized on investments he made with borrowed money, the interest on which -- $587,693 -- was also deductible. His tax for the year: $383!

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Taxpayer Z is an oil and gas man whose accountant must have told him about the tax advantages in farming. His income in 1966 was $2,142,382. From this he deducted $865,644 in excess oil depletion allowance, $828,571 in farm losses, and $336,695 as the tax-free portion of his capital gains. After adding in his contributions, interest and the like, he found he owed no income tax at all.

Against these examples of really outrageous (yet legal) tax avoidance one should compare the taxes being paid by ordinary citizens with ordinary incomes. In my last newsletter I pointed out that a couple with two children earning $5,000 must pay $304.50 in Federal income tax, including the 10% surtax. A couple making $10,000 must pay $1,169.70. Yet citizens such as those I have cited pay little or nothing.

What is even worse, the Treasury Department reports that 2.2 million families in this country with incomes *below the poverty level* are required to pay income taxes. For example, a couple with a meagre income of $2,200 must pay an income tax of $84.

Surely there can be no more dramatic statement of the need for comprehensive tax reform.

OTHER PROBLEM AREAS

There are a number of other problem areas in our tax code that I think need pretty thorough review. Ranking near the top of any list should be the following:

** A sound and time-honored policy in this country has exempted church property from taxes. We began with church buildings, convents, temples and ministers' residences. But now most major denominations find themselves in business, operating publishing companies, housing projects, farms and service stations. The profits from these businesses are tax-free. If you're in the grocery business and your church buys a grocery chain, it can undersell you and put you out of business. This is unfair. I believe churches should undoubtedly continue to have exemption as churches, but church-operated businesses ought to pay the same taxes paid by other businesses.

** The first $25,000 of corporate earnings is taxed at 22% to give a break to "small business." The rest is taxed at 48%. To take advantage of this concession many large corporations have split into collections of small corporations. If your corporation has $250,000 in profit, you can divide this up among 10 corporations and save $58,500. This dodge robs the Treasury of $235 million a year. Obviously, this was *not* the intention of Congress.

** The conglomerate corporation is one of the recent phenomena of the business world, a drastic threat to competition in major industries. It is also a lucrative device for reducing taxes. For example, if Ling Temco Vought files a consolidated tax return for this year with Jones & Laughlin Steel, as it apparently plans to do, the result will be a $25 million tax saving for LTV. Oddly enough, many of these mergers are being financed by the nation's taxpayers: corporate debentures paying high interest (which is deductible by the corporation) are being offered in trade for corporate stock paying lower dividends (which are not deductible), thereby gaining stockholder support for such mergers. The net result is that you are paying the cost of these lucrative mergers.

IS TAX REFORM POSSIBLE?

Before leaving office last January the outgoing Secretary of the Treasury proposed a list of tax reforms to put some equity back into our tax system. Hearings on these proposals have been started in the Ways and Means Committee, and hopefully they will be resumed shortly with completion of work on the 10% surtax extension. However, I think it's important to realize how tough that job is going to be.

The chances are pretty good that you belong to some organization or do business with some institution which benefits substantially from one or more of these tax loopholes. What's more, it is highly likely that one or more of these organizations will call upon *you* to use your influence to block reform. Collectively, these pressures can have a massive effect on the legislative process. Yet tax reform has never been more necessary or more urgently demanded by irate taxpayers.

Let me emphasize that you and I and every ordinary taxpayer have a real and vital stake in this situation. The effect of the many tax loopholes is to cut the tax *base* in half -- and thus to double the tax *rate.* Closing loopholes can mean lower tax rates for all of us.

At the same time, I'm sure we're not going to end *all* tax preferences. Special consideration for the blind, the aged, the cost of medical care, reasonable contributions to charity, Social Security benefits and the like will certainly continue.

SOME GUIDING PRINCIPLES

As I've studied our tax system over the years I've come to a number of general conclusions which you might find of interest:

> ** The Federal income tax began simply as a means of raising money. It's become, in part, an instrument to accomplish social purposes: to spur investment, to help cities finance improvements, to encourage oil exploration, to help farmers, and so on. Having seen how these purposes become subverted, we ought to go slow in legislating more of the same. One such proposal now being considered: President Nixon's plan to use tax credits to encourage business to provide job training for the hard-core unemployed.
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> ** A tax preference is essentially the same thing as a subsidy; it reflects a decision of government to favor a particular group of citizens at the expense of all other groups. Since this is so, it might lead to greater discipline if we were to abolish all preferences and replace them with outright subsidies. In this way the people could decide whether the encouragement of "city slicker" farming was the best way to spend $145 million a year.
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> ** We ought to strive for reasonable uniformity in the preferences or subsidies we legislate. For example, we subsidize marriage by giving preferential rates to married couples filing joint returns. However, we don't subsidize it at a standard rate. A couple making $14,000 a year saves $510, but a couple making $300,000 saves $14,510. A fixed dollar amount would make more sense.
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> ** All preferences and subsidies ought to be subject to frequent review to make certain they're still justified and desired by the American people. None should be permanent. All should require explicit, periodic re-authorization. If we were forced to vote in Congress this year on whether we would maintain the oil depletion allowance at 27 1/2%, I'm convinced we would scale it down to a more reasonable level.

MUST THE RICH GET RICHER?

It seems that under our present system, the axiom that the rich get richer, and the poor get taxes, is operating. Whether that system is changed in any significant way depends in large measure on the interest shown by you and your fellow citizens. Unlike Boyle's Law, which says pressure is inversely proportional to volume, pressure on Congress is *directly* proportional to the volume of constituent mail. And this is the time for the supporters of tax reform to apply that pressure.

Sentiment in Congress for revision of our tax laws seems to be stronger right now than at any time in memory. It was particularly evident in the House vote June 30 on extension of the 10% surtax. Many congressmen who recognize the need for surtax extension simply voted "nay" as a way of demanding action on tax reform. The bill passed, 210 to 205, but I think the message was clear to the Administration.

While I voted to extend the surtax, for the reasons cited in my last newsletter, I too have signaled such a message. I believe tax reform *must* be the next order of business.

In my next, and final, report in this series I'm going to deal with the greatest problem of all, not only for our country but the world. Everything I have discussed in these newsletters relates to it, and is made more difficult because of it. That problem: overpopulation.

I'll appreciate your comments.

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